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Apr. 7, 1999 **LETTER 1275**

PRICE ACTION: On March 29 -- finally, Wall Street's dream came true: the Dow closed above 10000. No question about it, the move was historic. But what did it mean? If it meant anything, it meant something to a bullish public loaded to the hilt with funds and stocks. And it meant something to the nation's newspapers, always hungry for news. Almost every newspaper in the nation featured Dow 10000 on its front page, but few (the *New York Times* was one) noted that, *"The stocks in the S&P 500 were on average 22.6% off their highs as of Friday, while on the NYSE, issues were on average 33.4% below their peaks. Showing just how concentrated this rally has been among big stocks, the Nasdaq stocks are on average 41.8% below their peaks. And this calculation factors in many of the hot technology and Internet stocks."* (The preceding paragraph from the *NY Times,* March 30.)

OK, let's forget Dow 10000 for a moment, and examine some of the price action. First, despite new highs in the Dow and the S&P, almost every session since late-January has been marked by more new lows than new highs on the NYSE. In fact, a Ned Davis version of what has been termed, "The Titanic Syndrome," was triggered a few weeks ago when more than 100 new lows were registered within two days of a new high in the Dow. Of course, all these negative high/low statistics are a by-product of the **ongoing bearish breadth performance.** If week after week more stocks decline than advance, it stands to reason that new lows on the NYSE are going to outnumber new highs.

The big-cap stocks, although many have put in tops, are still very resilient to decline. On March 23, the day when the A-D ratio broke below its October 8 low, the Dow failed by a wide margin to confirm. For instance, the October low for the Dow was **7632.53.** Thus, on March 23, with the A-D ratio at a new low below its October low, the Dow was still better than 2000 points **above** its own comparable October low. In time, however, I expect the Dow to confirm the A-D ratio, meaning the Dow below 7632.53.

One area that I've been concentrating on is the relationship of my Primary Trend Index (PTI) with the Dow. Certainly I would expect the Dow and the PTI **to at least move in the same direction.** But this has not been the case. For instance, on March 29, with the Dow above 10000, the PTI (see page 2 chart) remained in a well-defined downtrend. Amazing and totally atypical.

What do I make of this strange action of the PTI compared with the Dow? Frankly, in the 28 years that I've been monitoring the PTI, I've never seen anything like it. My only conclusion is that there has seldom, if ever, been such a wide disparity between the Dow (and the S&P) and the rest of the market. This is another way of saying that a select group of big-cap stocks have been advancing in the face of the declining trend in the great majority of stocks on the NYSE, the AMEX and the Nasdaq. It's all very fascinating and dramatic, but it's also part of the **extended, almost tedious topping-out process** that has been going on ever since April 1998.

Conclusion: This is how I see the big picture. The **tops are in place on a long series of indices and averages.** The tops are also in place for hundreds, probably thousands, of individual stocks. But many of the big-cap stocks (plus many tech and net

Mar. 26 DJIA 9822.24; PTI 5305; A-D Ratio +2.30
Apr. 1 DJIA 9832.51; PTI 5299; A-D Ratio +2.29
Dow Yield: 1.61%; Dow Price/Earnings: 25.1
Dow 144-day MA: 9189; Dow 34-day MA: 9695
Dow Times Book Value: 6.16; PTI 89-day MA: 5327
Percentage of Undervalued Blue-chips: 7%
Gold 34-day MA: 289

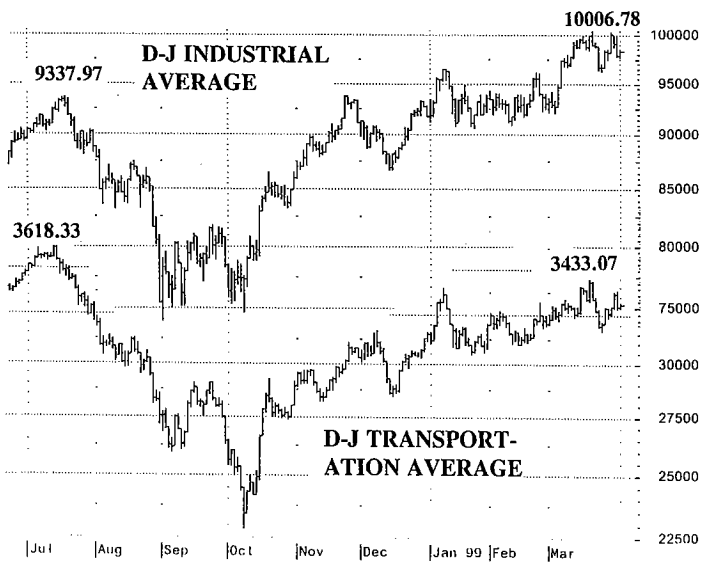
stocks) are still "alive and kicking." Result: The bear just isn't ready yet -- for a broad, all-encompassing down-leg.

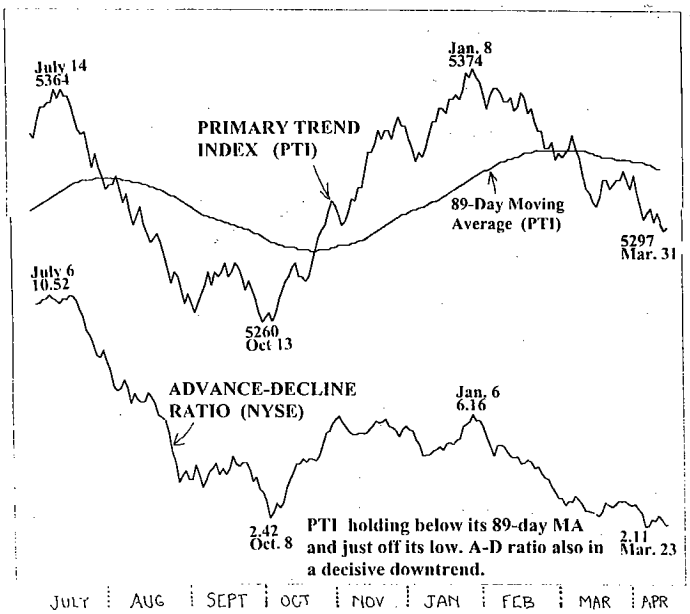
I'll remind subscribers again that in a bear market the moves in the primary (downward) direction tend to be slower, measured, often grinding -- while the upward corrections tend to be short, violent and exciting. I view bear market rallies as simply moves that "use up ammunition." Every rally in a bear market is part of a process of burning up fuel.

But what can we expect in the near-term? My guess is that we'll see more of what we've been seeing all along -- additional upside thrusts by the Dow, the S&P and the Nasdaq, **each up-thrust unconfirmed** by the PTI, the A-D ratio, the new high-lows, and a host of other averages and indices. How long can this go on? My guess again -- it will go on until we get **closer** to actual trouble in the economy. The great majority of stocks have already positioned themselves for trouble. The big-cap stocks, the tech stocks and the maniacal net stocks have ignored the downside.

You may not realize it, but the bear has a plan. The plan or strategy is to inflict the most damage to portfolios while at same time keeping people thinking "bull market." The following is what I **call "the bear's list"** (for some reason, nobody else runs this ominous list).

On October 3, 1997, **new highs** on the NYSE topped out at 631. That was the beginning of the "top-out parade." On April 3, 1998, the **advance-decline ratio** topped out at 13.00. On April 16, 1998, the **D-J Transports** topped out at 3686.02. On April 21, 1998, the **Value Line Composite** of 1632 stocks topped out at 508.39. On April 22, 1998, the **Russell 2000** topped out at 491. On October 9, 1998, the **D-J Utility Average** topped out at 320.51. On January 8, 1999, my **Primary Trend Index (PTI)**





topped out at 5374. On February 1, 1999, the **Nasdaq Composite** topped out at 2510.09. On March 18, the **S&P 500** may have topped out at 1316.55 (obviously, it's too early to tell). On March 18, the **NYSE Composite** may have topped out at 617.61. On March 29, the **Dow** may have topped out at 10006.78.

Question: How will news affect this market?

Answer: News can always affect the market on a one or two day basis. But the really important consideration is that the primary trend of the market turned down in April 1998. The single hardest thing for investors to understand is that **we are in a bear market, a tidal decline, a primary reversal with long-term implications**. So forget today's news, forget the bullish (or even bearish) comments you read in the papers or hear on TV. The tide is slowly running out, that's the single critical concept to keep in mind.

Question: Russell, all along you've pointed to the stubborn refusal of the Transportation Average to confirm the Dow on the upside. With the Transports now comprising such a small component of the stock market, why do you still place so much emphasis on their action?

Answer: In the 40 years that I've been writing these Letters, I guess I've had to defend the validity of the Transports maybe twice a year. The fact is that the Transports handle the traffic, the shipping, the vacation travel, the air, truck and rail movement. Love 'em, hate 'em, ignore 'em, **the Trannies work.** In 1974, the refusal of Transports in October to confirm the December low in the Dow called the end of the bear market. In 1998, at the April high, the refusal of Transports to confirm the new high in the Dow called the end of the bull market. Transports -- they work.

But haven't the Transports lost importance, economically, over the years? True, they have, maybe on a decade to decade basis, but they haven't lost importance over the last year. So why, with many months of **bargain 10-dollar oil,** haven't the Transports been able to get over their high of last April? The answer -- Transports are looking ahead, and they don't like what they are seeing. And, of course, that's the way the Dow Theory works. The Averages rise together if they like what they see ahead. They go down together or diverge if they don't like what they see ahead.

Question: Russell, are you telling us that in the face of all the constructive predictions by the top experts in the nation -- that there is major trouble, maybe a recession or depression, in our future?

Answer: I'm not telling you about the future -- the stock market is. Look, I'm just a market student and a writer; I report what I believe the stock market is telling us. According to my market studies, we're in the early phase of a primary bear market.

Question: The Fed has learned an awful lot since its mistaken even disastrous policies of 1929. With the current very active Fed, how can a major bear market be in the making?

Answer: Each bear market serves up something different. For instance today, unlike 1929, the various markets and nations of the world are intimately connected. Today, when a Brazil or a China or Germany runs into trouble, it affects us. So when a bear market starts, we never know what the bear sees or what trouble will arrive. What's more -- **we don't have to know.** Look, when I'm standing on the railroad track and the train is bearing down on me, I don't have to know the name of the train or where the train is coming from. What I do have to know is that if I want to stay alive I have to get off the track. It's the same thing in a bear market.

Question: C'mon, Russell, don't be cute, at least give us a few guesses as to what you think might be behind this bear market.

Answer: If you insist. One guess is **world deflation.** If the world deflates, debt becomes a Frankenstein and bankruptcies become epidemic. A second guess involves a progression: first, the market starts sinking of its own weight. Noting this, people turn cautious and cut back on their current wild spending. With **consumers cutting back,** corporate profits decline, and in the face of declining profits -- price/earning ratios head south. And remember, it's P/E ratios that provide the **big leverage** behind market movements. If the current record high P/E ratios start heading towards normal ratios -- well, hang on, it's going to be a wild ride down.

Question: What would you say if the Averages turned around and both the Dow and the Transports rose to new highs?

Answer: I doubt that's going to happen, but if it does, then I'd say that what we saw was a very extended correction in a bull market, a bull market that somehow was still alive. As far as the thesis, "It's a bear market if the Dow declines by 20% or more," I don't know who started that nonsense, but it is absolute nonsense. If the Dow drops 19.9%, it's not a bear market, but if the Dow drops 20.1%, it is a bear market? Give me a break. Already, the great majority of stocks have taken a beating, many a severe beating. So already the situation looks to me like it's a lot more than just a correction. Furthermore, the fact that this deterioration has been going on for almost a year suggests that it's much more than "just a correction." But to each his own. My prediction -- give the bear time, and before 1999 is over, I don't think there'll be many arguments about whether this is a bear market or not.

DISBELIEF: I listen to CNBC from 5:45AM (California Time) to half an hour after the market closes. I listen, not because I want to be guided by the various "experts" who offer their opinions -- no, the reason I listen to CNBC is that it provides an ongoing insight into market sentiment. So far, the sentiment remains highly bullish. A few of the experts are of the opinion that "we could see as much as a 5% to maybe even a 15% correction." Nobody, it seems, is entertaining the idea that the great primary trend of the market has turned down. In other words, nobody is talking "primary bear market."

Why no bear market talk? A number of reasons: **(1)** Because probably 90% of the current experts have had no experience

with bear markets; they don't know how bear markets work or even what a bear market looks like. **(2)** Because business conditions today are good, and the experts don't understand how you can have a bear market in the face of rosy business conditions. **(3)** Because the experts (and certainly the public) don't really understand that the market ignores yesterday and today and is concerned only with tomorrow. **(4)** Because (in the case of fund managers and brokers) the idea of an old fashioned bear market is so frightening that they put the very concept of a bear market out of their conscious minds. **(5)** Because most people can not conceive of change. But the market most definitely can envision change. The market can see far ahead of any expert or group of experts. And when a bear market (or a bull market) starts, the market is saying, "You probably don't see it, but major changes are coming." **(6)** Finally, arrogance. Experts, professionals, stockholders, particularly at bull market tops, tend to become very arrogant. They've made some money, they've become heroes to themselves and to their friends, and they make the fatal mistake of confusing a bull market with genius. Therein lies their downfall. Arrogance -- it's a killer where investing is concerned.

THE PICTURE: You know that old story about the frog in the pot of water on the stove. The burner is on and the water in the pot is gradually warming. The frog is feeling good. A few minutes later the frog feels exhilarated as the water turns even warmer. Finally, the water reaches 140 degrees and the frog passes out. A few minutes later the water comes to a boil and the frog heads to amphibian heaven. It was all so gradual that the frog never realized what was happening, nor did he realize that the way to safety was to jump out of the pot.

Let's talk about the S&P 500, which is the average that most of the pros watch and trade (they trade it via the futures and options). Recently, *Barron's* (Monday, March 22) listed the price-earnings ratio for the S&P at a record **34.46.** How did the P/E for the Dow and the S&P ever get to this incredible high without scaring people to death? The answer -- it did it **gradually** as per the frog in the pot.

The historical **danger level** for the S&P used to be a fat 20 times earnings. When the S&P hit 20 times earnings, savvy investors would think, "This has got to be the top." Now consider this: if today the S&P was just to sell at the old danger area, at 20 times earnings, it would sell for 754. That's just 58% of today's price. Switching to the Dow, if the Dow was to sell at 58% of today's prices, it would sell for 5740.

Now consider this: Ned Riley, a strategist at BancBoston, calculates that only 20% of the rise in the S&P 500 since 1990 has come from an increase in profits. **But 80% of the rise has come from the rise in price/earnings ratios.** In other words, it's the **multiple of the earnings** on the S&P which has been the huge upside "kicker." If the S&P was to sell at say its historical average of around 15 times earnings it would sell at 566. In 1974, the S&P sold at 7 times earnings. If the S&P was to sell at its 1974 price/earnings ratio it would sell at 264. If the Dow was to sell at its 1974 price/earnings ratio, about 7, it would sell at 2736, or if you'd rather use yields -- if the Dow was to sell at a yield of 6% (this was its yield in 1974), it would sell at 2644.

Let me give you an example of how sentiment can change. Back in the '40s (when I first got fascinated with the stock market), the widely-accepted "formula" for buying high-grade blue-chip stocks was that they should sell at 10 times earnings and provide a yield of at least 6%. That was the accepted criteria for buying the best stocks.

In an article (April) for *Money* magazine, my friend, Jim Grant, offers some comments about 1942. *"Is 1999 a new era? If so, I say, give it wide berth; it's the old eras that provide the buying opportunities. In my next reincarnation, I intend to come back as a clear-sighted and liquid American investor in the spring of 1942. The world was at war, capitalism was in retreat, and the prognosis for humanity itself was guarded. Naturally, stocks were on the bargain table (as seemed reasonable in view of the circumstances). Compare that with the present day, with the world at peace, capitalism ascendant and America in a bull market glow. Naturally, stocks are more expensive than ever, and this seems reasonable -- it isn't."*

Wait a second James. I can tell you that the year 1942 was most definitely not a fun year. I was there. That was the year (1942) that I graduated from Horace Mann School for Boys in Riverdale, NY. The next year I attended Rutgers as a freshman, and during that freshman year I enlisted in the army (I was called to active duty three months later). Believe me, nobody was thinking about the stock market in 1942. Most people were not even aware that the stock market existed in 1942. In April of 1942, the Dow sank to an extreme low of **92.92.** There were reasons. In mid-1942 it looked very much as though the Allies were going to lose the war. At that time the Dow could have dropped to 5 as far as I was concerned and as far as most Americans were concerned (they had already been knocked out of the stock market during the early years of the Depression).

Of course, the ironic part of it was that **April 1942 represented one of the greatest times in American history to load up on stocks.** But in 1942 nobody was even slightly interested in the market, nobody gave a damn, nobody talked about the stock market or glanced at the stock market tables. The stock market was a non-issue, a non-event. If there was any emotion about the stock market at that time, it was either distrust or downright hatred.

Compare that with today. Today everybody is enthralled with the stock market. Today everybody reads about the market. Buying stocks today is not an investment process, **it's a sport.** Yet our president at this juncture wants the Social Security Trust to buy stocks. And *USA Today* in headlines (March 31) asks, "Have You Missed the Market Boom? Millions losing billions as money languishes in banks." But today, as I see it, is probably one of the worst times in history to buy stocks.

How can I say that? I can say it because I know the history of human sentiment. It can change, and **it will change.** Sentiment, optimism, and bullishness is now at their highest levels in stock market history. I know that because I know that valuations are at their highest level in history.

What could possibly cause a drastic change in sentiment? What could take stocks down to extreme lows, lows that would seem impossible today? I honestly don't know. I can guess. I could give you a long list of "events that you don't want to know about but which could happen."

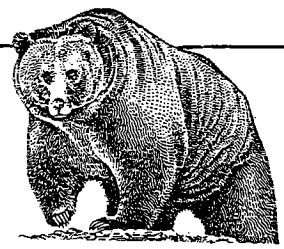
I can only tell you the market and human nature invariably **swing to extremes**. Science can advance, politics can advance, social policy can advance -- but **human nature remains the same**. People get far too optimistic and then they get far too pessimistic. The only thing that changes is the degree of the swings and the timing.

Question: Russell, you talk about a bear market which could take the Dow down below 3000. But how could that happen today with every government in the world printing currency as fast at they can? Wouldn't that prevent a collapse?

Answer: Well, it has so far. But the unending printing of money will cause inflation. Inflation causes interest rates to rise, and rising interest rates are anathema to a high-priced stock market. Look, I don't pretend to know what will cause the bear to win the battle. It could be deflation, it could be war, it could be US consumers deciding that instead of spending their heads off, it's time to save. Do you realize what would happen if something should come along to scare US consumers, to cause them (God forbid) to actually save?

Consumers are now loaded with debt, but optimism has kept them spending. Much of that optimism is based on the rise in the stock market. Thus, a symbiotic relationship now exists between the market and the consumer, with **each feeding off the other.** It's a tenuous situation, and I leave it to you to guess at what could happen.

Note: I just computed the following: the top 10 stocks in the S&P 500 are valued at 21.7% of the entire S&P. The top 20 stocks comprise 34.9% of the entire S&P. So is there any question that a handful of stocks are moving the S&P (buyers of index funds should take this into consideration)?



INVESTMENT POSITION: The bear stays in the box. I want to say a few words about bullish analysts. Being a perpetual bullish analyst is the way to go in this business, and it's hard to blame these analysts. The truth -- nobody wants to hear a bearish opinion. After all, what do you do if you believe a bear? You buy T-bills. Hardly very exciting. And from the analyst's standpoint, if he's bullish and wrong, well, he can just adjust his opinions down. Furthermore, probably all the other analysts got caught being wrong, so where's the danger to his job? Finally, a brokerage house will never fire an analyst because he was bullish and wrong. Remember the old broker's joke, "Hey, when was the last time your office manager asked you whether your customers are making a profit?" That's hardly the question the manager will ask, what he will ask is, "How are your sales this month, Charlie?" Conclusion: It almost never pays an analyst (particularly a brokerage house analyst) to be bearish. To put it another way -- a pink slip is a piece of paper looking for a bearish analyst. That's the truth in this business.

Happily, I have no brokerage house to fire me. Furthermore, I can turn bullish (and I have) when everybody else is bearish. The place to be right now is in a safe place. Try US T-bills. And stay out of Europe -- the euro is tanking (could we be looking at an one-dollar euro?).

NOTES & QUOTES: Well, we've got about one-third of our subscribers hitting our www.dowtheoryletters.com web site daily. For the complete novice I recommend buying an iMac, which comes with a modem. Find yourself an Internet Service Provider (ISP); your local telephone company probably offers a reasonably priced ISP. The iMac will cost you around $900 and the ISP will cost you between 10 and 20 bucks a month. This will serve fine for writing, and for getting on the net. If you want more speed, then get hooked onto a cable line for your ISP, offered by local TV cable companies (cable is not available in all areas), and that will cost you $40 to $50 a month. I started with Macs, I love them, and I think the Mac system is more reliable and basically a better system than the PCs. The only drawback is that the iMac may not have enough software for some purposes, but for the average subscriber an iMac and a phone line ISP (or the cable ISP) is all you'll need. By the way, most advisories charge extra (often a lot extra) for a daily update. Dow Theory Letters subscribers get the daily comments and updates free, zip, gratis, no extra charge. **Note:** Microworkz Computer sells a computer for $299 -- monitor additional at $99. This computer is selling so fast the only problem is delivery. For Internet access, it's fine.

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Two weeks ago the Commerce Dept. reported that durable goods orders for February dropped 5%, the biggest drop in seven years. Housing sales have been down two months in a row. However, economists haven't treated the news as the beginning of a manufacturing slump and many noted that these reports are volatile and subject to revision. My feeling is that 85% of the stock market is already discounting the possibility of a slowdown (dare we call it a recession) in the fact that the advance-decline ratio (proxy for all NYSE stocks) has been declining for the last year.

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In an interesting article in *Newsweek* (April 5), economist Robert Samuelson notes, "There are ominous signs that the great growth industry of the 1990s may be getting mature." He writes that "the PC explosion, and everything associated with it from software to ISDN lines, has been the driving force of the US economy. It has, for example, propelled strong business investment, as companies overhauled offices, factories and customer networks. In 1990, company purchases of high-tech equipment were 20% of all business investment . . . By 1998 it was 40%. And over the past decade, the computer industry (including software) has generated about one million new jobs." But Samuelson now believes that growth in computers is petering out. "By units, American PC sales rose 13, 20 and 19 percent in 1996, 1997 and 1998. Fred Hickey (publisher of the *High-Tech Strategist*) expects growth to collapse. 'You've reached saturation.' Sales revenues will stay flat or drop because fierce competition will depress prices, profits will suffer. Stocks will slump. The hurt will affect satellite industries, computer chips and software." Anyway, that's the view of Robert Samuelson. He ends his article by noting that IBM pretax loss on its PC business had jumped from $161 million in 1997 to $992 million in 1998. "This signals overcapacity and downward price pressure. The PC boom and America's boom have gone hand in hand. At least one may be wobbly." **Russell Comment:** One thing is obvious -- competition in the PC business is vicious and prices for computers are sliding almost by the month.

* *

Why should President Milosevic back off when President Clinton explicitly stated that no ground troops would be sent in? Ah, the plan -- you see Milosevic knows that Clinton is a chronic liar, thus Milosevic knows that somewhere along the line US troops will be sent in. According to this theory, Clinton is well aware that nobody believes anything he says, and thus, his "no troops" promise will clearly be the chief pressure point on Milosevic.

* *

Internet stocks: Bill Gates said of the 10 leading net stocks, it would surprise him "if even two of them would be in a leadership position 20 years from now." The reason, he told a small group of journalists in NYC, is that the barriers to entering the net business are now so low that new competitors will constantly emerge to drive down prices and profits. As a result, Gates opined that net stocks "in the aggregate" are overvalued. Gates didn't mention specific companies but he noted that upstarts such as Onsale.com and Buy.com have begun selling computers and other items at wholesale prices or below.

* *

Back on January 8, Amazon.com hit a high of 200 (the stock is now around 145). In 1998 on revenue of $610 million AMZN lost $124 million. The company is valued at $22 billion, larger than Sears. On top of that, the company just completed a $1.25 billion convertible bond issue. Buying AMZN is now an act of faith. Can it make any money before competition starts chewing it up? Will it ever make a profit? What's it worth? Who really knows? Meanwhile, new IPOs keep coming out and running up to outrageous prices above the issuing price. Is this almost a racket? No it's legal -- just part of the 1999 mania.

* *

Ah yes, America's teenagers, we love 'em (I still have one, my 18-year old daughter, Lauren, who graduates from La Jolla High this year). But what's this? The latest craze is on-line trading by teenagers. No, it's not possible, but it's happening. Is this a great country or what!

On-Line Trading Becomes a Teenage Craze

By Amy Joyce
Washington Post Service

WASHINGTON — Clad in baggy jeans and surrounded by sports memorabilia by adults. But evidence abounds of youths' rising interest in the market. High school stock clubs are bulging (the one at Jason's school has about 80 members), and about 200,000 American teenagers across the country are investing. tracted downturn in the stock market a quarter-century ago.

"Kids want to know about investing," said Mike Rauer, a history teacher and founder of the economics club at Bishop Ireton High

* *

Subscribers ask me how we could have a BIG bear market. What fundamentals could take the Dow, for instance, down below 5000? All right, I'll give you two examples. Americans could become frightened and cut back on their buying. The clip below from *US News & World Report* provides a hint of things to come. Another potential problem is debt, as the second clip (from *Investor's Business Daily)* suggests. Debt is great in an inflationary bull market. Debt's a major problem in a bear market. In a deflationary bear market, debt is pure murder.

Shop until they drop

How long can U.S. consumers carry the world economy?

By John L. Allen

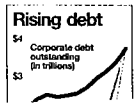
In Greek mythology, Atlas was forced ... union unions are buying fewer manufactured goods made in America apples, steel, and airplanes, pushing tens of thousands of American ... cy. Although the Senate is unlikely to support the legislation, the bill is a sign that U.S. protectionist sentiment is spread-

USA TODAY · TUESDAY, MARCH 23, 1999 · 3B

Corporations piling up more debt

Competition spurs firms to borrow

By Rich Miller
USA TODAY



Experts say companies are borrowing more because their profits are being plucked by competition. According to the Fed, corporate debt outstanding jumped 10.2% to $3.7 trillion last year. That followed an 8.2% rise in 1997 and was the biggest increase since 1984.

So far, that has not caused ... fell Monday on expectations that investors will sell Treasury securities to buy AT&T's higher-yielding corporate debt.

The key 30-year T-bond fell ½ point, or $2.50 per $1,000 face value. Its yield, which moves opposite to its price and which serves as a benchmark for long-term interest ... in 1997 and the highest level since 1989, Loukl says.

John Youngdahl, senior economist at Wolf Street broke Goldman Sachs, says corporate executives are putting more money into buybacks because the value of their stock option depends on how the share price ...

* *

We have three **flat screens** by Apple here, and we love them. I also bought a larger screen by Silicon Graphics and it's terrific. A 15" Apple flat screen will cost about $1100, but it's worth it. If you do buy a flat screen, make sure it's **digital.** Sony, by the way, will be opening a flat screen factory here in San Diego. I would imagine that within a year the price of flat screens will come down substantially.

* *

Dell, a former wonder stock, has topped out. But get this -- Dell has made more money selling puts and calls on its own stocks than it makes selling computers. In the past three years, Dell made over $3.1 billion selling options, more than its net income for the same period which was just $2.4 billion. But now, with high volatility, Dell may not find it so easy to make money selling options. And the stock may have to face just making profits on its business. This may be why the stock has taken a dive.

* *

Everybody is asking about Y2K and the honest truth -- nobody has the answer as to whether it will be a pain in the neck or an all-out disaster. One interesting item: evidently 90% of the software used in China is pirated. Now there's a case for major Y2K trouble. Actually, what I hear is that the real trouble will come from overseas suppliers, many of whom don't have any idea of how to deal with the Y2K problem.

* *

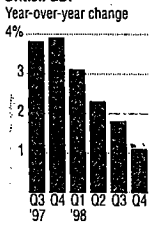
Yeah, I know, every central bank in the world is turning out more paper currency, trying to reflate, trying to revive business. But with it all, I can't discount world deflation. I read 11 newspapers a day, and often what you don't catch in 10 newspapers, you'll catch in the eleventh. Anyway, I keep running into little items like the two below. World deflation -- it could be what's happening.

Europe Industrial Prices Drop At 2.4% Yearly Rate

▶ Industrial producer prices in the 15-member European Union fell 0.3% in January vs. December. In the 11 Euroland nations, prices fell 0.3% in January and 2.7% from a year ago. Those drops were slightly more than expected. Factory prices fell 2.2% from a year ago in Euroland and 2.3% in the entire EU. Capital goods prices rose 0.1% on the year in both the EMU and the EU.

Brits Revise GDP Down; Growth Hits Six-Year Low

▶ The British economy grew at a slower pace than previously estimated in the fourth quarter of 1998. Gross domestic product rose just 0.1% on the quarter and 1.1% on the year. That's down from original estimates of



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New York University's law school has offered Hillary Clinton an associate professorship, according to a high ranking source in the Democratic party. Another Democratic source says, "It's not a lot of work. Maybe she lectures once a week and it gives her a good New York platform if she decides to run. Maybe she'll pull a Stephanopoulos and take the job, then not show up." **Russell Comment:** I'm all for her taking the job if it keeps her out of California.

* *

I thought I was tired of Mafia movies. The I watched HBO's "The Sopranos." I thought this was the best drama on the screen, with ABC's "Law and Order" second. "NYPD" I guess might be third, but it's getting a bit stale with too much "soap opera" stuff taking over. But "The Sopranos" is a terrific, well-written, gripping series, and it will be back next year.

* *

My old friend, Jim Blanchard, died two weeks ago at the tender age of 51. Jim was a major factor in legalizing gold through weeks, months and years of tireless effort. I attended Jim's first gold-investment conference back in 1974, and I attended most of his seminars since. Jim was the first to institute huge investment seminars featuring nationally known speakers (Reagan spoke at an early Blanchard seminar). I had dinner with Ayn Rand at one of Jim's get-togethers. Amazingly, Jim ran all his seminars and businesses from a wheel chair (result of an auto accident). So sad to say, it's adios to a long-time friend. Good-bye, Jimmie.

* *

Optimism: In a sharp turnaround, 77% of the "trendsetter" CEOs are now optimistic about the next 12 months, says a PricewaterhouseCoopers poll. That's up 34 points from the third quarter. Eighty-five percent are of the opinion that we're in a growth environment, 71% say it's moderate. **Russell Comment:** That's very encouraging, but I feel safer trusting the market.

* *

Price of a cheeseburger with large fries and soft drink according to Runzheimer, International: Warsaw, Poland -- $3.31; Memphis -- $4.20; Dallas -- $4.28; Miami -- $4.40; San Francisco -- $4.83; Honolulu -- $5.16; NYC -- $5.68; London -- $6.08; Geneva -- $8.37. **Russell Comment:** Why should I pay 20% more in London and 40% more in Switzerland? No rip-off for me, I'm staying right here in the US.

* *

Oh, oh, mistake. In the last Letter I quoted Burt Dohmen to the effect that the Dow is a capitalization-weighted index. Not true, the Dow is price-weighted, for instance, giving twice as much weight to a $100 stock as a $50 stock. Crazy, but true. A stock's influence on the Dow is cut in half just by declaring a two for one split (thanks to Jim Stack, InvesTech Research, for this correction).

* *

This is one for your scrapbook. Priceline.com came out last week with an IPO. The stock was offered at $16 a share and traded at issue day as high as 85 and settled at 69. This gave Priceline a market value of $9.8 billion, highest first day value ever for a net company. Priceline has been in business only 11 months. On sales of $35.2 million, the company last year had a loss of $114 million. Jay Walker, the company's founder, ended the day with paper wealth of $4.3 billion. Walker's previous claim to fame was that he started Newsub services, which sells magazine subscriptions in credit card bills. In 54 years of watching markets, I've never seen anything like this -- it's a mixture of greed, insanity and mass mania. It will all go down in history as competition to the tulip craze.

Advances and Declines: I've been getting a lot of questions regarding how the advance-decline ratio is figured. Easy, take the differential (daily) between advances and declines. Then divide that differential by the total number of issues traded (advancing, declining and unchanged). If more issues advanced than declined, add to the running total. If more issues declined, subtract from the running total. You can start the A-D ratio anywhere, 1000, 15000, 90000, anywhere. Example: You start at 10000. The next day there were 1500 advances and 500 declines. Differential was +1000. Divide 1000 by number of

issues traded (say 3550 that day) and your answer is .28. Add that to 10000 and the final figure for the day is 10000.28.

I might add that the A-D ratio is one of the most fundamental statistics that the market provides. Nothing is more basic than how many issues are up and how many are down each day. Of course, going along in importance with the A-D is how many 52-week highs and how many 52-week lows are produced each day. In a strong bull move, the A-D will rise, the new highs will expand and the new lows will contract. That's hardly what's been happening this year on any of the exchanges.

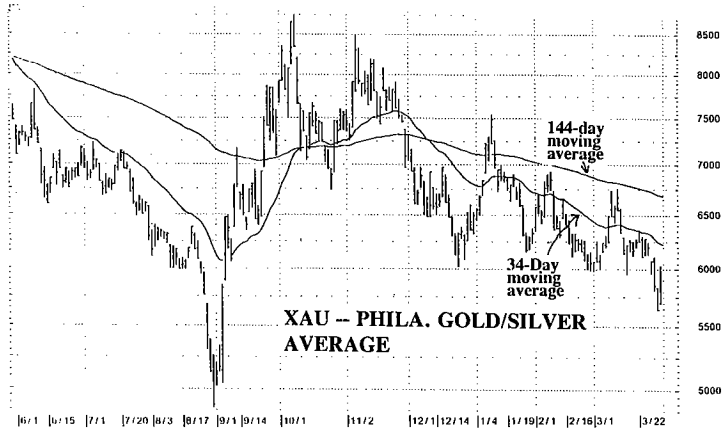
Just as nature abhors a vacuum, the stock market hates divergence (divergence produces a technical vacuum in the market). **And just as nature wants to fill a vacuum, the stock market wants to close a divergence.** In the current instance, divergence is created when the big averages either hold or advance in the face of a decline by the great majority of issues as measured by the advance-decline ratio.

Ultimately, in cases of divergence such as the current one, either the big averages will decline to eliminate the divergence or the A-D ratio will rise to close the divergence. In the great majority of cases, it's the averages that will decline to get in line with the majority of stocks. The current divergence between price and breadth is one of the most flagrant in stock market history. It's a vacuum that WILL be filled in due time.

In a recent Letter I wrote that the world is in the grip of **deflationary forces** including over-capacity and an almost total lack of "pricing power" (the inability to raise prices). This brings to mind my warning -- in the face of deflation and recession, nations have a choice – **"inflate or die."** Nations and their central banks across the face of the globe have now made their choice, and the choice is **INFLATE.** Every central bank is expanding its respective money supply. OPEC has just agreed to cut oil production, thereby driving up oil prices. Wealthy nations have upped funding for the IMF. Clinton has come out in favor of "forgiving" debt in many recession-laden third world countries. The USDA has provided extra credits for certain nations so that these nations could avoid default. The USDA has also given huge amounts of emergency funds to US farmers to help them through hard times. The Fed has refused to raise rates despite the surge in the big-cap stocks and despite the frantic, really unprecedented speculation in Internet stocks. The Fed has also pumped up the money supply to an extent seldom seen before. It's a deadly struggle and the unspoken slogan around the world is -- **inflate or die.** Of course, the problem continues to be **world over-production** of almost everything, and, ironically, by providing surging liquidity and dis-allowing failure, the **problem of over-capacity is made even worse.**

GOLD: The rumor is that central banks want to keep gold in the 280 to 300 range and that suits many hardened gold traders as well. As gold approaches 280 buyers come in; as gold nears 300 sellers take over and rumors of IMF gold sales are revived. With gold now just above 280, it will be interesting and important to see whether gold can mount a rally back towards 290-300. In the meantime, most gold stocks have been smashed down to what would seem to be bargain levels. Barrick Resources near 17, Homestake just over 8, Placer Dome around 11, Newmont Mining at 17 ½, Agnico Eagle just over 5. Whew!

The chart of XAU, the Phila. Gold/Silver Average shows the story. The extreme low was hit on August 31, 1998 at 48.8. Last week XAU declined to a closing 56.4, then rallied a bit. The first ray of hope would be the XAU advancing above its 34-day moving average at 62.1. A much more important achievement would be XAU pushing to 67, which would be above its mid-March peak and also above its 144-day MA which now stands at 66.8. Gold-philes, keep your fingers crossed.



NOTES: We've received some calls from subscribers who aren't picking up the latest comments or PTI figures at www.dowtheoryletters.com. If you aren't seeing recent updates when you get to the members' area of the website, please click on your **refresh** (Internet Explorer) or **reload** (Netscape) button, located on the icon bar. That should do it for you.

Our daily web site is offered to **regular subscribers only** -- sorry, we have no facilities to offer the daily web site to trial subscribers. Also, the regular Letters are available (so far) by mail only -- it is not offered via E-mail or the web.

LATE NOTES: In this business you have to learn that it's not the actual news that's important -- **what is important is the stock market's reaction to the news.** Over the weekend I received many calls from subscribers, most informing me the "battle in the Balkans" would be the death knell for this market. Not so, not if we are to believe the **early** Monday morning stock action. As I write this and judging from **early** action the market believes that the crisis in the Balkans will be contained and that it will not be a problem. That reaction **may change by tomorrow,** but that's the way I read the market this morning.

If there's been any real surprise over recent weeks it's been the nasty decline in the bond market with the Treasury's long bond now pushing yields to around 5.6%. And, according to some "experts," if the US economy continues to do well (and spending for the "war" increases), we'll soon be looking at 6% yields on the long T-bond (this with the Dow yield at 1.61%).

All in all, it looks to me as though we are going to have more of the same in the stock market. By "the same" I mean that we will see the big-cap stock averages (Dow, S&P, Nasdaq) continuing their upward thrusts -- while the majority of stocks fail to join in the party. How long this can go on is anyone's guess (it's been going on for a year now). The only thing I can say is that this extraordinary period of price-breadth divergence will end badly -- and the **longer it goes on, the worse the aftermath.**

The fund-buying public is becoming increasingly frustrated with their funds because their funds are failing to keep up with the S&P or the Dow. The solution -- buy the index funds. The result -- the big-cap stocks climb higher and higher into the clouds of overvaluation. It's an unprecedented situation -- but it's also well to remember that "trees don't grow to the sky."

Finally, this current period, I believe, will go down in history as the era when all the time-honored concepts of valuation went out the window. At the latest reading of the S&P 500, we see a yield of 1.28% and a P/E ratio of 34.31. These are never-seen-before valuations, indicating a faith in common stocks (or at least big-cap stocks) that borders on the fantastic.

NEXT MAILING: Apr. 21, 1999